

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

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| Central Illinois Light Company, Cinergy Corp., |) | |
| Hoosier Energy R.E.C., Inc., Southern |) | |
| Illinois Power Cooperative, Southern Indiana |) | Docket No. ER01-731-000 |
| Gas & Electric Company, and Wabash Valley |) | |
| Power Association, Inc. |) | |

**COMMENTS OF THE
ILLINOIS COMMERCE COMMISSION
AND THE
MICHIGAN PUBLIC SERVICE COMMISSION**

Pursuant to Rule 211 of the Commission’s Rules of Practice and Procedure, 18 C.F.R. § 385.211, and the Commission’s December 27, 2000, Notice of Filing, the Illinois Commerce Commission (“ICC”) and the Michigan Public Service Commission (“MPSC”) hereby submit Comments in the above captioned proceeding.¹ The ICC and MPSC have direct and compelling interests in the creation of a properly constituted and effectively managed Midwest regional transmission organization (“RTO”). The people of Illinois and Michigan cannot achieve the benefits of legislatively mandated retail electric market deregulation until and unless a fully competitive, transparent and liquid wholesale market for energy is established in the Midwest region. Such a wholesale market is unlikely to emerge except in conjunction with a *single* RTO, one that is independent from generators and local distributors of electricity and able to provide non-discriminatory, reliable and economic open access to

the grid. Accordingly, the ICC and MPSC respectfully request that the Commission find it in the public interest to require mandatory arbitration that will result in the creation of a single, optimal Midwest RTO. Such action would render moot the request of Central Illinois Light Company (“CILCO”), Cinergy Corp., Hoosier Energy R.E.C., Inc., Southern Illinois Power Cooperative, Southern Indiana Gas & Electric Company, and Wabash Valley Power Association, Inc. (collectively “Petitions”) to (1) withdraw from the Midwest ISO effective on the date the Commission first allows the withdrawal from the Midwest ISO of Illinois Power Company, Commonwealth Edison Company and/or Ameren to take effect; and (2) have the Commission authorize a Designated Transmission Owner having Commission jurisdictional rates and charges to recover, through its Commission jurisdictional transmission service rates and charges, the costs incurred by the Designated Transmission Owner as a result of its withdrawal from the Midwest ISO.²

INTRODUCTION

In Order 2000,³ the Commission reaffirmed its findings in Orders 888⁴ and 889⁵ that the development of competition in the electric markets is necessary to protect the public interest.⁶ While the

¹ In its Intervention and Protest which is being filed jointly with the Commissions of Ohio, West Virginia, Indiana and Iowa, the MPSC endorses broad principles that the Commission should adhere to in addressing RTO formation in the Midwest. The MPSC joins with the ICC in these comments to further elucidate its position.

² See, Letter, *Central Illinois Light Company, Cinergy Corp., Hoosier Energy R.E.C., Inc., Southern Illinois Power Cooperative, Southern Indiana Gas & Electric Company, and Wabash Valley Power Association, Inc.*, Docket No. ER01-731-000 (filed Dec. 20, 2000)(“Petitioners’ Withdrawal Letter”).

³ Order No. 2000, *Regional Transmission Organizations*, 65 Fed. Reg. 809 (Jan. 6, 2000), FERC Stats. and Regs. ¶ 31,089 (1999), *order on reh’g.*, Order No. 2000-A, 65 Fed. Reg. 12,088 (Mar. 8, 2000), FERC Stats. and Regs. ¶ 31,092 (2000).

⁴ Order No. 888, *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Services by Public Utilities and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 Fed. Reg. 21,540 (May 10, 1996), FERC Stats. & Regs. ¶ 31,036 (1996), *order on reh’g.*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 4, 1997), FERC Stats. & Regs. ¶ 31,048 (1997), *order on reh’g.*, Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh’g.*, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

⁵ Order No. 889, *Open Access Same-Time Information System (Formerly Real-Time Information Networks) and Standards of Conduct*, 61 Fed. Reg. 21,737 (May 10, 1996), FERC Stats. & Regs. ¶ 31,035 (1996), *order on reh’g.*,

Commission took action in its previous orders to protect the public interest by promoting competition through open access to the Nation's transmission system, in Order 2000 the Commission found that the continued reliance on vertically integrated utilities to manage the transmission grid created significant impediments to the development of competition in the electricity markets.⁷ The Commission ordered the development of RTOs to address certain problems stemming from the vertically integrated electric utilities' control of the Nation's transmission system. Specifically, the Commission intended to protect the public interest by removing "opportunities for unduly discriminatory conduct by cleanly separating the control of transmission from power market participants."⁸

In Order 2000, the Commission initially chose to defer to the voluntary efforts of the vertically integrated utilities to develop effective RTOs.⁹ While the creation of RTOs through such voluntary efforts has proven to be a difficult task in all regions of the Nation, the task has been more manageable in regions where pre-existing tight power pools provided a foundation for organization. However, transmission owners in the Midwest region, which has a grid that is architecturally unique, remain divided as to the proper structure, governance and configuration of an RTO for the region. Further, no agreement has been reached among market participants in the region as to the structure and functionality of a properly constituted market for electricity. The voluntary efforts on the part of vertically integrated

Order No. 889-A, 62 Fed. Reg. 12,484 (Mar. 14, 1997), FERC Stats. & Regs. ¶ 31,049 (1997), *order on reh'g.*, Order No. 889-B, 81 FERC ¶ 61,253 (1997).

⁶ Order No. 2000, slip. op. at 3.

⁷ *Id.* at 2-3.

⁸ *Id.* at 4.

⁹ *Id.*, slip op. at 115.

utilities in the Midwest region have clearly failed to result in the formation of an effective Midwest RTO.

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Instead, competing proposals have entrenched the transmission owners and other interested parties in the region; and the region is currently presented with two sub-optimal RTOs, neither of which will serve the public interest by managing the transmission grid in an effective manner. The Midwest ISO is the result of an extensively debated compromise among numerous public and private stakeholders. The Alliance RTO contrasts as an agreement among certain investor-owned utilities that could not support the compromise reached by the parties to the Midwest ISO agreement. Neither organization represents a consensus of regional interest or an optimal model for management of the uniquely configured Midwest grid. The Petitioners' requests to withdraw from the Midwest ISO and to have a Designated Transmission Owner authorized to recover the costs of such withdrawal through Commission jurisdictional rates are simply symptoms of the over-arching problem of RTO development in the Midwest region.

With the efforts to develop a Midwest RTO entering the sixth year, the costs are rising and no benefits are in sight. Barely eleven months remain for an RTO to emerge in the Midwest that will comply with the operational readiness deadline adopted by the Commission in Order 2000. Therefore, to protect the public interest, the Commission must take the opportunity presented by the functional unreadiness of these two, competing organizations to develop a coherent, unified RTO for the Midwest region. Such action would render moot the Petitioners' requests in this proceeding.

¹⁰ See, Letter to the Honorable Chairman Hoecker regarding "Action Needed - Midwest Electric Market," signed by Environmental Law and Policy Center, Industrial Energy Users - Ohio Coalition of Midwest Transmission Customers, Project for Sustainable FERC Energy Policy, Natural Resources Defense Council, Ohio Consumers' Counsel, Wisconsin Industrial Energy Group, Missouri Public Counsel, and Citizens Action of Indiana, Inc. (dated December

The most appropriate vehicle to achieve this result is a mandatory arbitration proceeding. The process must be mandatory because the voluntary efforts to date have resulted in the region's current RTO development problems. Further, a mandatory arbitration proceeding is necessary because the difference in the present administrations of the Midwest ISO and Alliance RTO will continue to hamper progress towards the creation of a unified Midwest RTO. A single, optimal RTO for the Midwest region cannot be achieved except through the mandatory arbitration of a Commission appointed and empowered, disinterested third party. Given the harm to the public interest that will result from continued delay in the development of an optimal RTO in the Midwest region, the Commission must act immediately.

STANDARD OF REVIEW

In the Midwest ISO Order, the Commission approved certain withdrawal provisions but ordered that "any notice of withdrawal from the Midwest ISO Agreement must be filed with the Commission and may become effective only upon the Commission's approval."¹¹ Notably, however, the Commission did not articulate the standard that would apply to its review of transmission owning utilities' requests for withdrawal from the Midwest ISO. This minor omission has been seized upon by certain utilities to argue that the public interest is not applicable to such requests.¹² Such assertions must be rejected.

12, 2000)(describing the RTO development problems occurring in the Midwest region). The ICC and MPSC support the concern raised by these parties within the context of this letter.

¹¹ Order Conditionally Authorizing Establishment Of Midwest Independent Transmission System Operator And Establishing Hearing Procedures, *Midwest Independent Transmission System Operator, Inc.*, 84 FERC ¶ 61,231, slip op. at 63 (Sept. 16, 1998).

¹² See e.g., Motion for Leave to Answer and Answer of Dynegy Inc. and Illinois Power Company, *Dynegy Inc. and Illinois Power Co.*, Docket No. ER01-123-000, at 6-7 (Dec. 11, 2000)("IP Withdrawal Proceeding")(addressing a similar request to withdraw from the Midwest ISO by Illinois Power Company).

The Commission has the unquestioned authority, and indeed a mandatory obligation, to ascertain that the exercise of business under its jurisdiction is conducted in a manner consistent with the public interest. Section 201 of the Federal Power Act (“FPA”) provides as follows:

It is hereby declared that the business of transmitting and selling electric energy for ultimate distribution to the public *is affected with a public interest*, and that Federal regulation of matters relating to ... that part of the business which consists of the transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce *is necessary in the public interest*....

16 U.S.C. § 824(a)(emphasis added). Accordingly, the scheme of regulation over which Congress empowered the Commission is designed to ensure the protection of the public interest, and it has long been established that the purpose of the powers granted to the Commission is the protection of the public interest.¹³

Utilities subject to the Commission’s jurisdiction cannot utilize the power of contract to abrogate the Commission’s duty to ascertain that all practices subject to the Commission’s jurisdiction are consistent with the public interest. For instance, in the IP Withdrawal Proceeding, Illinois Power argued that section 205 of the FPA,¹⁴ pursuant to which the Commission approved the Midwest ISO Agreement in the Midwest ISO Order, imposes a just and reasonable standard on the Commission’s review of requests to withdraw, and that such a just and reasonable standard simply “requires a finding that a proposal is cost justified and consistent with the underlying contract.”¹⁵ Thus, Illinois Power concluded that its withdrawal is just and reasonable, and not unduly discriminatory, as long as Illinois Power had “met the [privately negotiated] contractual requirement for withdrawal.”¹⁶ Such a construction would restrain the Commission in its review of withdrawals to a mere determination of

¹³ See, *Federal Power Comm’n v. Sierra Pacific Power Co.*, 350 U.S. 348, 355 (1956)(“Sierra”).

¹⁴ 16 U.S.C. § 824(d).

whether the requesting utilities' private economic interests are satisfied in a manner consistent with the private bargains struck by the same utilities in the relevant contract, i.e., the Midwest ISO Agreement. Such a construction of the Commission's duties under the FPA wholly ignores the Commission's paramount responsibility to ascertain that utilities' contractual affairs are conducted in a manner that is consistent with the public interest.

Moreover, such a construction must be rejected because it is contradictory to well-established legal principles. The law has long held that jurisdictional utilities' contractual rights are always dependent on the utilities' exercising those rights in a manner that is consistent with the public interest.¹⁷ In *Mobile*, the United States Supreme Court expressly held that jurisdictional contracts, and the parties' rights thereunder, "remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest."¹⁸ Also, in the companion case *Sierra*, the Supreme Court held that the public interest standard is the standard of review to be utilized by the Commission in reviewing whether existing contracts comport with section 206 of the FPA,¹⁹ even though the explicit language of section 206 does not contain the term "public interest" but rather provides that jurisdictional contracts cannot be "unjust, unreasonable, unduly discriminatory or preferential."²⁰ The Supreme Court explained that when the jurisdictional utility has protected its own interests through its contractual rights "the sole concern of the Commission would seem to be whether [the contract] adversely affect[s] the public interest – as where it might impair the financial ability of the public utility to continue its service, cast upon other

¹⁵ Answer in IP Withdrawal Proceeding, at 6-7.

¹⁶ *Id.* at 7.

¹⁷ See, *United Gas Pipe Line Co. v. Mobile Gas Serv. Corp.*, 350 U.S. 332, 344 (1956) ("Mobile").

¹⁸ *Id.*

¹⁹ 16 U.S.C. § 824e.

²⁰ *Sierra Pacific Power*, 350 U.S. at 355.

consumers an excessive burden, or be unduly discriminatory.’²¹ The Supreme Court elaborated as follows:

That the purpose of the power give the Commission by § 206 is the protection of the public interest, as distinguished from the private interests of the utilities, is evidenced by the recital in § 201 of the [FPA] that the scheme of regulation imposed ‘is necessary in the public interest.’ When § 206 is read in light of this purpose, it is clear that a contract may not be said to be either ‘unjust’ or ‘unreasonable’ simply because it is unprofitable to the public utility.

Id. The rationale is that jurisdictional utilities should have all contractual rights of other entities; but, given the Congressionally recognized need to regulate the industry in the public interest,²² such contractual rights must be restrained by the public interest. Accordingly, the Commission can always change jurisdictional utilities’ contractual rights when necessary to protect the public interest.

In this case, the Commission’s reservation of its right to review utilities’ withdrawals from the Midwest ISO reflects the Commission’s intent to determine whether such withdrawals are in the public interest. In fact, as the jurisdictional utilities requested approval of the Midwest ISO Agreement pursuant to section 205 of the FPA, the logical conclusion is that the Commission’s reservation of authority and the current review equates to an exercise of its authority to review utilities’ actions pursuant to the Commission’s own motion under section 206 of the FPA. Thus, the Supreme Court’s ruling in the *Mobile-Sierra* companion cases is directly applicable to the Commission’s current review, i.e., that the Commission’s standard in reviewing proceedings initiated pursuant to section 206 is the public interest standard. The purpose of the Commission’s review cannot simply be discarded because the Commission did not articulate the public interest standard within the context of the Midwest ISO

²¹ *Id.*

²² 16 U.S.C. § 824(a).

Order. Indeed, as the legal precedence discussed above clearly illustrates, the Commission's weighing of the public interest is presumed.

DISCUSSION

A public interest finding in this case should be based on the thesis that the principle purpose of an RTO is to provide reliable, efficient and economic service to all customers and to all local, retail customers. The private, economic interests of vertically integrated utilities in pursuing their alternative business options must only constitute a secondary concern. Further, a public interest finding should consider the benefits that can reasonably be expected from the continued separation and reconfiguration of the Midwest ISO and Alliance RTO versus the benefits that can be expected from creating a single, optimal Midwest RTO.

As explained below, accepting the reconfiguration that will result from the migration of the Petitions from the Midwest ISO will not satisfy the public interest because such a situation will fail to achieve the goals adopted by the Commission in Order 2000. On the other hand, a single, independent RTO that is optimally designed to manage the grid in the Midwest region will achieve the Commission's RTO goals and bring benefits to consumers in the Midwest region. The Commission must institute a mandatory arbitration to require the creation of such an optimal RTO because the vertically integrated utilities' private economic and financial self-interest will prevent the development of such an RTO through voluntarily actions.

I. THE CREATION OF A SINGLE, UNIFIED, INDEPENDENT RTO CAPABLE OF OPTIMALLY MANAGING A GRID OF UNIQUE DESIGN AND ARCHITECTURE IN THE MIDWEST REGION IS THE ONLY WAY TO SATISFY THE PUBLIC INTEREST.

A pre-existing, tight power pool does not exist in the Midwest region that is large enough to provide a foundation for organizing an RTO. Rather, the Midwest region has a uniquely configured, highly disaggregated grid with approximately two dozen control areas. The Midwest also needs an

RTO that will assure the development of a unified, non-pancaked tariff for a single geographic region, will foster consolidation of control areas as a precondition to improving grid management and will create one of the largest, and likely most liquid, markets for power in the United States.

The public interest cannot be satisfied by adopting *in toto* either the Midwest ISO or Alliance RTO model because neither model, as presently described in filings before the Commission, represents an optimal model for management of the uniquely configured grid in the Midwest region. Indeed, these organizations have not, at this time, even addressed the complexity of managing a highly disaggregated grid with approximately two dozen control areas. Nor have these organizations addressed a near total lack of experience in coordinated dispatch of power, an entirely undefined market structure, and inconsistent security and reliability regulation spanning at least four NERC councils. Further, these organizations appear to lack commitment to certain operational issues, including but not limited to the consolidation of control areas, the coordinated management of control centers and the clarification of native load preference. Therefore, it cannot be accepted that either the Midwest ISO or the Alliance RTO, once operational, will produce measurable improvement in transmission service in the Midwest region. The pursuit of either the Midwest ISO or the Alliance RTO model will not produce the public interest benefits that the Commission intended from the development of RTOs.

The shortcomings in the designs of the Midwest ISO and Alliance RTO models are illuminated by the cumulative experience of RTO development in other parts of the country. Extensive knowledge has been accumulated about the operational experience, both negative and positive, of the California ISO/PX, the PJM Interconnection, the NE-ISO and the NY-ISO. Also, numerous positive proposals have been made that identify and describe the separate public, quasi-public and business functions expected to be provided by an RTO as well as mechanisms to rationalize these different functions within

an RTO. Most importantly, we now know that the structure, functionality and regulation of an RTO's associated markets are central to the RTO's ability to fulfill its mandate. This knowledge should be utilized to redesign the RTO model for the Midwest into a single, optimally organized RTO for the region.

Notably, the ultimate structure of the single, unified RTO may contain certain of the elements existing in the current Midwest ISO and Alliance RTO models. In other words, we can use our current knowledge of proper RTO development to redesign the Midwest ISO and Alliance RTO models into a single, optimal RTO for the Midwest region.²³ The outcome of such efforts could include the positive aspects of the Alliance RTO, such as the creation of a for-profit entity that is economically motivated to provide superior transmission service. At the same time, the ultimate solution could contain the Midwest ISO's constituent-driven demand for independent oversight of non-operational, non-business public policy functions, such as those of reliability and security policing, market monitoring, regional planning and expansion, and alternative dispute resolution. The oversight organization could also accommodate advisory committees of stakeholders and public interest representatives.

Overall, the development of a single, optimally organized RTO for the Midwest region would be, by definition, more beneficial than either one or two sub-optimal RTOs. First, a single, optimally organized RTO will achieve the Commission's objectives for RTOs adopted in Order 2000, and it will achieve these objectives at a lesser cost than either of the two sub-optimal RTOs. Second, such an RTO would assure the development of a unified, non-pancaked tariff for a significant geographic region, would foster consolidation of control areas as a precondition to improving grid management, would

²³ Notably, however, the construction of a new Midwest RTO must not be limited in its development to the designs of these pre-existing models even though it may be possible to borrow some positive features from these models.

improve liquidity in the market, and would create one of the largest markets for power in the United States. In sum, a single, optimal RTO would produce tangible and immediate benefits unlikely to be achieved by retaining the entirely artificial, self-imposed separation of the Midwest ISO and Alliance RTO, or by pursuing *in toto* either of the RTO models currently under development by the Midwest ISO and Alliance RTO.

II. AT THIS POINT IN TIME, A MANDATED ARBITRATION PROCEEDING IS THE MOST EFFECTIVE MANNER BY WHICH THE COMMISSION CAN LEGITIMATELY CREATE A SINGLE UNIFIED MIDWEST RTO AND, THEREBY, SATISFY ITS PUBLIC INTEREST OBLIGATION.

A. Mandatory Arbitration Is Necessary To Satisfy The Public Interest Standard.

As discussed above, the Commission adopted its RTO policy in Order 2000 to protect the public interest by removing the impediments to competition that traditional management of the transmission grid by vertically integrated electric utilities impose. While recognizing that RTOs cannot be formed instantaneously, the Commission found that it was necessary to impose a definitive deadline.²⁴ To do otherwise would enable the formation of RTOs to continue indefinitely and be detrimental to the public interest. In adopting the deadline of December 15, 2001, for all RTOs to attain operational status, the Commission explained as follows:

As a general proposition, we believe that, given the urgent needs of electricity markets as discussed elsewhere in our Final Rule, we have an obligation to promote RTO operation at the earliest feasible date. Even where a market may already be served by an ISO or other approved transmission entity, we are concerned that such market may remain hampered to the extent that the approved entity has yet to fully conform with our Final Rule.

Id., slip op. at 669-70.

²⁴ Order 2000, slip op. at 669-70.

Accordingly, to enforce this deadline, the Commission vowed to take further regulatory action when the industry fails, through voluntary efforts, to take the steps necessary to develop appropriate RTOs in accordance with the Commission's timeframe. The Commission stated as follows:

As a result of [the Commission's] voluntary approach, we expect jurisdictional utilities to form RTOs. If the industry fails to form RTOs under this approach, the Commission will reconsider what further regulatory steps are in the public interest.

...

Our adoption of a voluntary approach to RTO formation in this Final Rule does not in any way preclude the exercise of any of our authorities under the FPA to order remedies to address undue discrimination or the exercise of market power, including the remedy of requiring participation in an RTO, where supported by the record.

Id., slip op. at 4, 101.

The ICC and MPSC concur that the Commission has the duty to impose mandatory remedies to remove the power of utilities to discriminate or exercise market power in activity being exercised pursuant to the Commission's jurisdiction.²⁵ Further, the ICC and MPSC believe that the current situation in the Midwest region necessitates direct Commission action. Such action should take the form of a mandatory arbitration process to begin immediately. The ICC and MPSC believe that mandatory arbitration under the current circumstances is necessary for two reasons.

First, although the ICC and MPSC recognize that the creation of RTOs has proven to be a difficult task in all regions of the nation, the time for experimentation with transmission institutional

²⁵ In fact, the ICC, MPSC and several other Midwest State commissions have long been recommending that the Commission adopt a mandatory RTO regime to remedy to problems created by the vertically integrated utilities maintaining control over the Nation's transmission system. See e.g., Petition, *In the Matter of the State Public Utility Commissions and Public Service Commissions of States Indicated Herein for Technical Conference or Regional Hearing*, Docket Nos. ER98-1438-000 and PL98-5-000 (filed Feb. 27, 1998)(submitted by State Public utility and Public Service Commissions of Arkansas, Illinois, Kansas, Michigan, Minnesota, Missouri, North Dakota, Ohio, Oklahoma, Pennsylvania and Texas); ICC Comments, *Midwest Independent Transmission System Operator, Inc.*,

models has passed. As stated above, the Commission imposed a deadline of December 15, 2001, for RTOs satisfying all of the structural characteristics and operational requirements of Order 2000 to be operational.²⁶ Accordingly, less than one year remains for an RTO to emerge in the Midwest that will comply with Order 2000's operational readiness deadline.²⁷ While more information will be available once the Midwest ISO and Alliance RTO make their Order 2000 compliance filings on January 15, 2001, experience shows that an ISO can fail to achieve full viability as a transmission institution even if it meets the characteristics and functions adopted by the Commission in Order 2000. Therefore, the Commission must not delay in initiating the steps that are necessary to ensure that an effective RTO is operational in the Midwest region by the December 15, 2001, deadline. Continuing to rely on the minor tweaking of two sub-optimal RTOs in the Midwest region is unproductive and falls short of satisfying the public interest.

Second, the uniqueness of the Midwest grid and the conflicting interests of the RTO participants have prevented, and will continue to prevent, the parties from achieving an Order 2000 compliant Midwest RTO through their voluntary actions. Both the Midwest ISO and its participants as well as the Alliance RTO participants have been given a sufficient opportunity to arrive at a reasonable consensus regarding the appropriate RTO structure for the Midwest region. The recent history of these efforts, however, demonstrates that the utilities have only succeeded in creating two sub-optimal RTOs.

As explained above, the Midwest ISO and Alliance RTO represent two competing proposals that arose from the inability of stakeholders in the Midwest region to agree to the proper structure, governance and configuration of an RTO for the region. The Midwest ISO is the result of an

Docket Nos. ER98-1438-000, EC98-24-000, at 7-9 (Mar. 16, 1998); ICC Comments, *Alliance Companies*, Docket Nos. ER99-3144-000 and EC99-80-000, at 6 (July 7, 1999).

extensively debated compromise among numerous stakeholders. The Alliance RTO contrasts as an agreement among certain investor-owned utilities that could not support the compromise reached by the parties to the Midwest ISO agreement. Neither organization represents a consensus of regional interest or an optimal model for management of the uniquely configured Midwest grid.

The dissimilarities between the two organizations is exemplified by their current governance structures. The Midwest ISO has an independent policy-making Board of Directors, two advisory committees, and a management staff that is assumed to comply with Order 2000 requirements. The Alliance RTO, on the other hand, has no independent Board or staff. Instead, the Alliance RTO members, all vertically integrated utilities, retain full decision-making authority over the organization's governance. No clear separation of interest exists to differentiate between Alliance RTO members as "generators and distributors of electricity" and as "transmission owners."

Importantly, the governance and other differences between the Midwest ISO and Alliance RTO will prevent, and have prevented, the two organizations from voluntarily negotiating to create a single, optimum RTO for the Midwest region. The Midwest ISO and Alliance RTO undertook negotiations during much of the year 2000, but their attempts were unsuccessful. It is a simple fact that the interests the two organizations represent are not coincident.

The failure of the utilities' voluntary efforts to date means that the Commission must not rely on such voluntary efforts to resolve the problems facing the development of an Order 2000 compliant RTO in the Midwest region over the next eleven months. The Commission must implement a process

²⁶ Order No. 2000, slip op. at 669-70.

²⁷ Neither the Midwest ISO nor the Alliance RTO has received approval as an Order 2000 compliant RTO.

immediately that is designed to protect the public interest. In short, a mandatory arbitration process is necessary to alleviate the current impediments to the creation of cohesive and viable Midwest RTO.

B. The Mandatory Arbitration Process Must Be Clearly Defined.

The ICC and MPSC emphasize that any mandatory arbitration process created and overseen by the Commission should possess certain defining characteristics designed to ensure a successful end result – the creation of a single, unified Midwest RTO. The Commission must establish specific guidelines for the procedural framework of the arbitration as well as a strict deadline for a final result. At a minimum, the ICC and MPSC recommend that a mandatory arbitration process contain the elements discussed below.

First, the Commission must ascertain that primary emphasis is placed on the public interest. To date, reliance on the voluntary efforts of the vertically integrated utilities has placed primary emphasis on private business and financial interests. The private, economic interest of vertically integrated utilities in pursuing their alternative business options must only constitute a secondary concern.

Second, the Commission should assign an empowered arbitrator. The neutral arbitrator selected for this assignment could be a Commissioner, a senior Commission Staff person, an Administrative Law Judge, or a knowledgeable, experienced, respected, independent outsider appointed by the Commission. Also, the arbitration process outlined by the Commission should encompass an all-inclusive nature whereby all stake holders in the region have the opportunity to fully present their positions. The Commission should provide guidance and oversight to the arbitrator and stakeholders in the process. Such guidance and oversight should include, but not necessarily be limited to, providing a clear outline and description of the outcome desired by the Commission. Furthermore,

the arbitrator should be vested with the necessary authority to achieve the Commission's desired outcome. Only in this fashion will the Commission facilitate the efforts of the participants and ensure that a resolution consistent with the public interest is reached in the allotted timeframe.²⁸

Third, the Commission's guidelines must ascertain that the resultant Midwest RTO will be viable long-term. The RTO that will be entrusted by the Commission with operation of the Midwest grid should have to demonstrate a working knowledge of the lessons from the cumulative experience of the NY-ISO, NE-ISO, PJM Interconnection and California ISO/PX. Specifically, any prospective operator of the Midwest grid should be required to show, in detailed operational filings, the following:

1. How the grid will be managed in a manner demonstrably superior to the status quo;
2. Whether and how control areas will be consolidated;
3. How multiple markets for power will be organized;
4. What market rules will be adopted and why;
5. How the managers of the RTO will be held accountable;
6. What incentives will exist for superior performance; and
7. Who will govern the RTO at each point in development.

These design precepts should be imposed as conditions precedent to designation as a Midwest RTO.

In other words, the RTO should be fully independent, evolved, developed and intelligent on operational day one.

Fourth, the Commission should require that the design of market institutions be a major focus of the mandatory arbitration process. There must be an absolute commitment on the part of the transmission system operator to create a market structure of proven design that will function in conjunction with the RTO from the outset. Markets do not arise spontaneously out of trading

²⁸ The Commission has previously recognized the necessity of retaining authority to protect the public interests in all proceedings that take place pursuant to the Commission's authority. *See*, Order No. 578, *Alternative Dispute Resolution*, 71 FERC ¶ 61,036 at [31] (1995)(stating that "[t]he Commission obviously must reserve authority to ensure that decisions reached through ADR procedures are *not contrary to the public interest* or inconsistent with statutory requirements")(emphasis added).

opportunities. Particularly in the case of electric energy, with its uncompromising requirement for instantaneous balancing of supply and demand, experience shows the need to pro-actively organize the power markets.

Furthermore, when market participants lack confidence in the integrity of the market, the participants rely increasingly on spot trading. Markets dominated by spot trading are unstable and volatile. Therefore, the Midwest market structure to be established, and the related system operator role within it, should not be experimental. It should, rather, comprise the coherent, coordinated management of the inter-locking functions that represent the essential elements of an integrated market structure, as follows:

1. A real time balancing market;
2. A coordinated spot and forward market for transmission service and energy;
3. Bid-based, security constrained dispatch of energy at nodal prices;
4. Financially driven transmission usage;
5. A competitive market for ancillary services; and
6. Management of congestion solely via market instruments.

In sum, the Commission should not allow an RTO to arise in the Midwest region without a concomitant, proven market structure to support it; and no market structure should be permitted to emerge in the region without explicit oversight by the Commission.

Fifth, the arbitration must be mandatory on all parties. The voluntary nature of the Commission's RTO formation policy has been unproductive to this point. The Commission should, therefore, clearly identify the jurisdictional utilities required to participate in the Midwest RTO and mandate their compliance.

C. The Commission's Immediate Initiation Of The Mandatory Arbitration Process Will Render ComEd's Request To Withdraw Moot.

As discussed above, the Petitioners' current requests are symptoms of the over-arching problem of RTO development in the Midwest region. Addressing these symptoms while leaving the main problem untreated will not serve the public interest. Further, such action is likely to encourage further disarray in the development of an effective RTO for the Midwest region.

The mandatory arbitration recommended by the ICC and MPSC is a means of addressing and resolving the totality of the issues surrounding RTO development in the Midwest region. Specifically, the successful resolution of the mandatory arbitration will be a single, optimum RTO for the Midwest region, rendering moot the requests to withdraw ComEd and the other utilities from the Midwest ISO. The mandatory arbitration process will also resolve all other issues the Commission is currently facing, or will face, in regard to the further development of both the Midwest ISO and Alliance RTO. Specifically, the Commission currently has before it:

1. Docket No. ER01-123-000: Illinois Power's Request to Withdraw from the Midwest ISO, filed on October 13, 2000;
2. Docket No. ER01-780-000: Exelon Corporation, Commonwealth Edison company and Commonwealth Edison Company of Indiana, Inc. Request to Withdraw from the Midwest ISO, filed on December 22, 2000;
3. Docket No. ER99-3144-000/EC99-80-000: The Alliance Companies' Compliance Filing, filed on September 15, 2000;
4. Numerous RT Dockets established after the first round of Order 2000 compliance filings on October 16, 2000.
5. Docket No. ES01-13-000: The Midwest ISO Application to Issue Securities under section 204 of the FPA in an Amount Not to Exceed \$100 Million, filed on December 15, 2000.

The Commission should forego acting on these sub-issues independently and, instead, resolve all issues surrounding the development of a Midwest RTO within the mandatory arbitration proceeding.

In fact, even if the Commission acted on these sub-issues independently, the Commission's actions would not resolve the over-arching RTO problems facing the Midwest. The over-arching problem will continue until a mandatory arbitration proceeding designed to resolve the problem is finalized. Therefore, action on the sub-issues without a mandatory arbitration proceeding will render the Commission's action on the sub-issues somewhat irrelevant. The Commission should not consume time and resources to undertake such action but should, instead, consider all aspects of the development of a single, optimal RTO for the Midwest region as part of the mandatory arbitration proceeding.

III. IF THE COMMISSION CONSIDERS THE PETITIONERS' REQUESTS AT THIS TIME, THE COMMISSION MUST FIND THAT THE PUBLIC INTEREST STANDARD CANNOT BE MET INDEPENDENT OF A PROCEEDING TO CREATE A SINGLE, OPTIMAL RTO FOR THE MIDWEST REGION.

The position of the ICC and MPSC is that it is simply not possible for any utility to show, or for the Commission to find, that a request to withdraw from the Midwest ISO is in the public interest until such time as the design of the RTO or RTOs in the Midwest Region is more clearly defined. Accordingly, regardless of the Commission's actions on the Petitioners' current requests, the Commission must initiate a mandatory arbitration proceeding for the creation of a single, optimal RTO in the Midwest region.

The Commission must place the public interest first in its evaluation of the withdrawal requests. In other words, to receive Commission approval, the Petitioners should have to show that their withdrawal from the Midwest ISO is in the public interest. To make this evaluation, the Commission should require that the Petitioners' and any other utility's request to withdraw from an RTO be filed simultaneously with a request to join an alternative organization pursuant to sections 203 and 205 of the FPA. Then, the withdrawing utilities should be required to demonstrate how their proposed migrations

satisfy the public interest. This standard should require a consideration of costs, benefits, market organization and institutional intent.

While the reasons prompting the Petitioners' current requests differ from the reasons prompting other recent requests to withdraw from the Midwest ISO, the Commission should still apply the public interest standard in evaluating the Petitioners' requests. Specifically, the Petitioners base their reason for making their request on the requested withdrawals of Commonwealth Edison, Illinois Power and Ameren. The Petitioners state that such withdrawals from the Midwest ISO will (1) render the scope and configuration of the Midwest ISO deficient with respect to the Petitioners and their customers when measured against the minimum threshold standards of Order 2000; and (2) make it impossible for the Midwest ISO to operate the transmission system then remaining under the functional control of the Midwest ISO as an integrated system in compliance with Order 2000.²⁹ While these circumstances should be considered by the Commission in its public interest evaluation, the Commission should consider all other effects that the Petitioners' withdrawal may have on the public interest.

For example, the governance structure of the RTO that a utility belongs to is important in assessing whether the public interest is met. As discussed *supra*, significant differences exist in the governing structures of the Midwest ISO and Alliance RTO.³⁰ These differences should weigh on the Commission's decision to grant withdrawal. The Commission has previously recognized the difference in governance legitimacy between the two organizations.³¹ While the ICC and MPSC recognize that the Midwest ISO's current governance structure reflects a much greater degree of governance legitimacy than that of the Alliance RTO, the ICC and MPSC note that not all aspects of the Midwest ISO

²⁹ Petitioners' Withdrawal Letter at 3.

³⁰ See *supra* at 15 for a discussion of the difference in the governance structures of the two organizations.

governance structure produce desirable results. For example, the Midwest ISO's apparent inability to control start-up costs, to internalize and resolve disputes among its members, to become operational within a more reasonable timeframe or to negotiate a merger with SPP and the Alliance RTO represent serious short-comings.

Specifically, in considering the degree to which the Midwest ISO and the Alliance RTO, as presently constituted, can be deemed to mitigate the market power of member utilities, the decisions in two recent Commission Order are insightful. In the Commission's Order that approved the merger of ComEd and PECO Energy Company ("PECO"), the Commission determined that ComEd's membership in the Midwest ISO was sufficient to mitigate the potential market power of the merged utilities and, as a result, did not attach any conditions to the merger's consummation.³² On the other hand, in the Commission's order approving the AEP-CSW merger, the Commission found AEP's membership in the Alliance RTO to be insufficient to mitigate market power and, therefore, imposed conditions for third party, independent calculation of available transmission capacity and for third party market monitoring functions.³³

Further, the Commission should not grant the withdrawal petitions unless and until the Commission can assure itself that the migration of the utilities from the Midwest ISO to another RTO will not, in and of itself, represent a significant shift of costs among the utilities involved. The Midwest ISO's stranded costs could potentially exceed \$100 million. On June 1, 2000, the Midwest ISO issued

³¹ start-up costs, to internalize and resolve disputes among its members, to become operational within a more reasonable timeframe or to negotiate a merger with SPP and the Alliance RTO represent serious short-comings.

³² Order Authorizing Merger, *Commonwealth Edison Company on Behalf of Itself and Its Public Utility Subsidiaries and PECO Energy Company On Behalf of Itself and Its Public Utility Subsidiaries*, Docket No. EC00-26-000 (Apr. 12, 2000).

³³ *American Electric Power Co., Central and South West Corp.*, 90 FERC ¶ 61,242 (2000).

\$100 million in senior notes bearing interest at 8-3/4 percent with a maturity of 2012.³⁴ It was recently announced that the proceeds of this issuance will be exhausted by the end of the first quarter of the year 2001.³⁵ Accordingly, on December 15, 2000, the Midwest ISO submitted an application under section 204 of the FPA to issue additional securities in an amount not to exceed \$100 million.³⁶ A substantial portion of these costs may, in the end, be allocated to the departing utilities because their withdrawals will diminish the Midwest ISO's chances for viability. In fact, in the Midwest ISO's most recent section 204 application, the Midwest ISO requested that the Commission tie departing as well as remaining Midwest ISO members to the new financial obligation.³⁷

Similarly, the departing utilities could bear a double burden in the form of start-up costs. It can be expected that these utilities will be required to pay their share of the start-up costs for any RTO the utilities subsequently join. Thus, these utilities could be assuming a double burden for RTO start-up costs.

It should be anticipated that the utilities will seek to pass these additional costs on to consumers. Therefore, the Commission should require the utilities to address these issues by providing: (1) an assessment of the disposition of stranded costs associated with investments already incurred in the development of the Midwest ISO; (2) an evaluation of costs that will be required to start up any alternative RTO; and (3) a comparative analysis of pre- and post- migration transmission revenue requirements that may, in the end, be borne by native load customers in Illinois and Michigan.

Ultimately, however, it is clear that a decision that such requests are in the public interest cannot be made at this time. As stated above, it is simply not possible for any utility to show, or for the

³⁴ See, Application, *Midwest Independent Transmission System Operator*, ES01-13-000, at 2 (Dec. 15, 2000).

³⁵ See, *Id.*

Commission to find, that a request to withdraw from the Midwest ISO is in the public interest until such time as the design of the RTO or RTOs in the Midwest Region is more clearly defined. Accordingly, regardless of the Commission's actions on the Petitioners' current requests, the Commission must initiate a mandatory arbitration proceeding for the creation of a single, optimal RTO in the Midwest region.

³⁶ *Id.*

³⁷ *Id.* at 2-3.

CONCLUSION

WHEREFORE, for each and all of the foregoing reasons, the Illinois Commerce Commission and the Michigan Public Service Commission respectfully request that the Commission utilize a public interest standard in its review of the Petitioners' requests; exercise its statutory authority to initiate a mandatory arbitration process through which the Commission can be ensured that a single, properly designed and properly constituted RTO for the Midwest Region will be developed in a timely fashion; consider the Petitioners' requests only in conjunction with the other pending Midwest RTO development cases; and for any and all other appropriate relief.

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Respectfully submitted,

ILLINOIS COMMERCE COMMISSION

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